

KANSAS LEGISLATIVE RESEARCH DEPARTMENT

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November 9, 2005

To: Governor Kathleen Sebelius and Legislative Budget Committee

From: Kansas Legislative Research Department
Kansas Division of the Budget

Re: State General Fund Receipts for FY 2006 (Revised) and FY 2007

Estimates for the State General Fund (SGF) are developed using a consensus process that involves the Legislative Research Department, Division of the Budget, Department of Revenue, and three consulting economists from state universities. This estimate is the base from which the Governor and the Legislature build the annual budget. The Consensus Group met on November 3, 2005, and significantly increased the FY 2006 estimate and developed the first estimate for FY 2007.

For FY 2006, the estimate was increased by \$221.0 million, or 4.5 percent, above the previous estimate (made in June and subsequently adjusted for legislation enacted during the special session). The overall revised estimate of \$5.158 billion represents a 6.5 percent growth forecast above actual FY 2005 SGF receipts.

The initial SGF estimate for FY 2007 is \$5.218 billion, which is \$60.4 million, or 1.2 percent, above the newly revised FY 2006 figure. A number of factors influence the reduced FY 2007 growth rate, including legislation enacted in 2004 that reduces the amount of sales and use tax receipts deposited directly into the SGF; and significant increases in net transfers as a result of loan repayments to the Kansas Department of Transportation and other agencies.

Economic Forecast for Kansas

The Kansas economy is expected to continue to grow at a relatively robust rate for the balance of FY 2006 as the state continues to recover from the recession. Estimates of nominal Kansas Personal Income (KPI) growth for 2005 and 2006 (5.9 and 5.4 percent) are up substantially from the estimates used by the group in the spring (5.5 and 5.1 percent) for the same two calendar years. A healthy overall employment picture and a modest recovery in the aviation manufacturing sector are expected in the short term to continue to cause income tax withholding and consumer spending to grow at levels not seen since the late 1990s. Although economic growth is expected to continue throughout FY 2007 and beyond, the rate of growth will be declining. Estimates are that Kansas Gross State Product will grow by 5.8 percent in 2005, 5.2 percent in 2006, and 4.7 percent in 2007. The Consensus estimates contained herein are based on a number of such assumptions regarding a moderating rate of growth in the national and state economies.

Kansas Personal Income

KPI in 2004 grew by 5.0 percent over the 2003 level. After estimated KPI growth of 5.9 percent for 2005, the growth rate is expected to decelerate to 5.4 percent for 2006; and to decrease again to 5.1 percent for 2007. Current estimates are that overall U.S. personal income growth will be 5.9 percent for 2005, 6.5 percent for 2006, and 5.7 percent for 2007.

Employment

The employment outlook for Kansas remains healthy. The overall Kansas unemployment rate, which was 5.4 percent in FY 2005, is expected to be 5.2 percent in FY 2006 before dropping to 5.1 percent in FY 2007. Year-over-year job growth continued in September, 2005, for the 19th consecutive month, and the average annual number of Kansans employed in FY 2006 is expected to exceed 1.4 million for the first time in state history.

Agriculture

The All Farm Products Index of Prices received by Kansas farmers was 107 in September, compared with 104 a year ago. Kansas' 2005 wheat crop, which was 380 million bushels, represents a 21 percent higher yield than the 2004 crop. High levels of corn, sorghum, and soybean production are expected to push the final 2005 total production of Kansas' four major grain crops to 1.09 billion bushels. Beef prices through September were running significantly ahead of the previous year, although fewer cattle had been marketed thus far in 2005. Higher energy costs remain of a major concern for the agricultural sector, as does export capacity following the summer and fall hurricanes.

Oil and Gas

The average price per taxable barrel of Kansas crude oil is estimated to be \$55.00 for FY 2006 and \$50.00 for FY 2007. Gross oil production in Kansas, which generally had been declining steadily for more than a decade until FY 2000, appears to be stabilizing at around 34 million barrels per year. Half of all Kansas oil produced is not subject to severance taxation because of various exemptions in that law. The price of natural gas, which has been at historically high levels over the summer and fall because of hurricanes and other market forces, is expected to average \$7 per mcf for FY 2006 before declining to \$6.25 per mcf for FY 2007, based on an industry source's analysis of futures markets. Notwithstanding these high prices, production is expected to continue to decline for the foreseeable future as natural gas reserves, especially those in the Hugoton field, are depleted. Natural gas production in FY 2005 of 394 million cubic feet represented a continuing decrease from the recent peak of 730 million cubic feet in FY 1996. The current forecast is for 360 million cubic feet for FY 2006 and 335 million cubic feet for FY 2007.

Inflation Rate

The Consumer Price Index for all Urban consumers (CPI-U) is expected to increase by 3.5 percent in 2005. Unexpected energy price increases attributable to hurricanes and their disruption of energy supplies have caused this figure to be revised upward from the 2.4 percent estimate used last spring. The national forecasts for both 2006 and 2007 call for inflation to return to more moderate levels, 2.8 percent and 2.5 percent, respectively, once the energy supply disruptions have ended.

Interest Rates

The Pooled Money Investment Board is authorized to make investments in U.S. Treasury and Agency securities, highly rated commercial paper, repurchase agreements, and certificates of deposit of Kansas banks. In FY 2005, the state earned 2.27 percent on its SGF portfolio. The average rate of return forecasted for FY 2006 is 3.57 percent. For FY 2007, the forecasted rate is expected to continue to increase to 4.53 percent.

Economic Forecasts				
	<u>CY 04</u>	<u>CY 05*</u>	<u>CY 06*</u>	<u>CY 07*</u>
KPI Growth	5.0%	5.9%	5.4%	5.1%
Inflation (CPI-U)	2.7%	3.5%	2.8%	2.5%
		<u>FY 05</u>	<u>FY 06*</u>	<u>FY 07*</u>
SGF Interest		2.27%	3.57%	4.53%
Oil and Gas				
Oil Price per bbl	\$	44.46 \$	55.00 \$	50.00
Gross Prod. (000)		33,485	34,000	34,000
Gas Price per mcf	\$	5.13 \$	7.00 \$	6.25
Gas Taxable Value		1,863,574	2,318,400	1,926,250

* Estimated

Attached Tables

Table 1 compares the revised FY 2006 and new FY 2007 estimates with actual receipts from FY 2005. Table 2 shows the changes in the FY 2006 estimates relative to the June 14 estimates as subsequently adjusted for legislation enacted during the special session.

State General Fund Receipts Estimates

FY 2006. The revised estimate of SGF receipts for FY 2006 is \$5.158 billion, an increase of \$221.0 million from the previous estimate. It should be noted that the June informal revision for FY 2006 had added \$86 million to the previous estimate made in April. Thus, the new estimate – which factors in all legislation approved during the veto and special sessions – is \$307.0 million more than the April estimate. As noted previously, the overall revised SGF estimate represents a 6.5 percent growth forecast above final FY 2005 receipts. Details of the revised estimate are reflected in Tables 1 and 2.

Each individual SGF source was reevaluated independently and consideration was given to revised and updated economic forecasts, collection information from the Departments of Revenue and Insurance, and year-to-date receipts.

The estimate of total taxes was increased by \$214.7 million, while the estimate of "other revenue" was increased by \$6.3 million. Five tax sources – individual income, corporation income, sales, compensating use, and severance – accounted for \$208.9 million of the increase.

The estimate for individual income taxes was increased by \$100 million. A number of factors contributed to this upward revision, including the increased KPI growth projection, significant growth in withholding tax receipts, and the fact that receipts through October were running \$46 million above the prior fiscal-year-to-date estimate. Final FY 2005 receipts for this source grew by 8.6 percent over the previous year and finished \$10.6 million above the final (June) estimate and \$53.9 million ahead of the April estimate. The revised FY 2006 forecast represents 8.8 percent growth above the actual FY 2005 figure.

The estimate for corporation income taxes, which were running almost \$29 million ahead of the prior fiscal-year-to-date estimate through October, was increased by \$50 million. Continued strong corporate profit forecasts for the balance of 2005, coupled with the overall rebound in the Kansas economy and employment, are among the factors contributing to the recovery in receipts from this source -- now estimated to be \$260 million for FY 2006. Corporation income tax receipts were less than \$94 million as recently as FY 2002.

The sales and use tax estimates were each increased by \$15.0 million, based on strong fiscal-year-to-date receipts. The Department of Revenue reported that more than 80 retailers have voluntarily registered to collect use taxes since October 1, a fact that also contributed to the increase in that estimate. The sales tax growth rate is expected to moderate over the winter relative to the early months of this fiscal year because of the energy price increases and the fact that purchases of motor fuel and residential utility services are exempt from the sales tax.

The overall severance tax estimate was increased by \$28.9 million, with \$20.7 million from the revised natural gas estimate and \$8.2 million from the new oil tax estimate. As noted previously, the change is primarily attributable to the historically high prices for both of these commodities.

The insurance premiums tax estimate also was increased by \$6.0 million. Receipts from this source exceeded the final FY 2005 estimate by more than \$4.8 million.

The aforementioned higher SGF interest rate and increased balances led to an increase of \$8.8 million in interest earnings.

On the negative side, the estimate for agency earnings was decreased by about \$6.2 million; and the estimates for the motor carrier property tax, the estate tax, and the corporation franchise tax were decreased by a combined \$4.0 million.

FY 2007. SGF receipts are estimated to be \$5.218 billion in FY 2007, an increase of \$60.4 million or 1.2 percent when compared to the newly revised FY 2006 figure. The growth would have been \$52.7 million more if not for legislation enacted in 2004 that reduced the share of sales and use taxes earmarked for the SGF. The aforementioned loan repayments accounted for \$32.5 million of the increase in transfers out of the SGF. In fact, the reduced growth rate in overall SGF receipts from FY 2006 to FY 2007 is heavily influenced by the more than \$100 million negative change in the net transfers forecast. Severance tax receipts also are expected to decline by almost \$20 million because of slightly lower than expected prices of both oil and gas and decreased production of gas. The individual income tax forecast takes into consideration more modest growth in the economy and in KPI. Corporation income tax receipts are expected to remain at the same level as the previous year, based in part on estimates of little or no growth in corporate profits during 2006. Details of the FY 2007 estimate are shown in Table 1.

FY 2008 and thereafter. Although the Consensus Group will not make its initial estimate for FY 2008 until next fall, worthy of note is the fact that a number of provisions in previously enacted legislation will reduce SGF receipts beginning in FY 2008. The 2004 legislation relating to the amount of sales and use taxes deposited in the SGF will be expected to reduce FY 2008 receipts from these sources by a combined \$43.5 million below FY 2007 receipts. Given a 3.5 percent growth assumption, FY 2008 SGF receipts will be \$168.0 million less than they would have been if the 2004 legislation had not been enacted. Legislation enacted in 2002 that conforms the Kansas estate tax exemption threshold with the federal exemption threshold is expected to reduce receipts by \$8.5 million in FY 2008; \$11.2 million in FY 2009; and \$14.7 million in FY 2010. Legislation enacted in 2002 that also increased the tax credit for property taxes paid on commercial and industrial machinery and equipment is expected to reduce receipts by \$5.0 million in FY 2008; \$5.8 million in FY 2009; and \$6.7 million in FY 2010. Legislation enacted in 2005 will reduce the amount of water tax receipts deposited in the SGF by \$2.6 million in both FY 2008 and FY 2009; and by \$2.7 million in FY 2010. Additional legislation enacted in 2005 will reduce severance tax receipts to the SGF by \$5.2 million in FY 2009 and \$7.5 million in FY 2010.

Accuracy of Consensus Revenue Estimates

For 31 years, SGF revenue estimates for Kansas have been developed using the consensus revenue estimating process. Besides the three state agencies identified on the first page, the economists currently involved in the process are Joe Sicilian from the University of Kansas, Ed Olson from Kansas State University, and John Wong from Wichita State University. Each of the entities and individuals involved in the process prepared independent estimates and met on November 3, 2005, to discuss estimates and come to a consensus for each fiscal year.

STATE GENERAL FUND ESTIMATES

Fiscal Year	Adjusted Original Estimate*	Adjusted Final Estimate**	Actual Receipts	Difference from Original Estimate*		Difference from Final Estimate**	
				Amount	Percent	Amount	Percent
1975	--	\$614.9	\$627.6	--	--	\$12.7	2.1%
1976	\$676.3	699.7	701.2	\$24.9	3.7%	1.4	0.2
1977	760.2	760.7	776.5	16.3	2.1	15.8	2.1
1978	830.1	861.2	854.6	24.5	3.0	(6.5)	(0.8)
1979	945.2	1,019.3	1,006.8	61.6	6.5	(12.5)	(1.2)
1980	1,019.3	1,095.9	1,097.8	78.5	7.7	1.9	0.2
1981	1,197.1	1,226.4	1,226.5	29.4	2.5	0.1	0.0
1982	1,351.3	1,320.0	1,273.0	(78.3)	(5.8)	(47.0)	(3.6)
1983	1,599.2	1,366.9	1,363.6	(235.6)	(14.7)	(3.2)	(0.2)
1984	1,596.7	1,539.0	1,546.9	(49.8)	(3.1)	7.9	0.5
1985	1,697.7	1,679.7	1,658.5	(39.2)	(2.3)	(21.3)	(1.3)
1986	1,731.2	1,666.4	1,641.4	(89.8)	(5.2)	(25.0)	(1.5)
1987	1,903.1	1,764.7	1,778.5	(124.6)	(6.5)	13.8	0.8
1988	1,960.0	2,031.5	2,113.1	153.1	7.8	81.6	4.0
1989	2,007.8	2,206.9	2,228.3	220.5	11.0	21.4	1.0
1990	2,241.2	2,283.3	2,300.5	59.3	2.6	17.2	0.8
1991	2,338.8	2,360.6	2,382.3	43.5	1.9	21.7	0.9
1992	2,478.7	2,454.5	2,465.8	(12.9)	(0.5)	11.3	0.5
1993	2,913.4	2,929.6	2,932.0	18.6	0.6	2.4	0.1
1994	3,040.1	3,126.8	3,175.7	135.6	4.5	48.9	1.6
1995	3,174.4	3,243.9	3,218.8	44.4	1.4	(25.1)	(0.8)
1996	3,428.0	3,409.2	3,448.3	20.3	0.6	39.0	1.1
1997	3,524.8	3,642.4	3,683.8	159.0	4.5	41.4	1.1
1998	3,714.4	3,971.0	4,023.7	309.3	8.3	52.7	1.3
1999	3,844.7	4,051.9	3,978.4	133.7	3.5	(73.4)	(1.8)
2000	4,204.1	4,161.0	4,203.1	(1.0)	0.0	42.1	1.0
2001	4,420.7	4,408.7	4,415.0	(5.7)	(0.1)	6.4	0.1
2002	4,674.5	4,320.6	4,108.9	(565.6)	(12.1)	(211.7)	(4.9)
2003	4,641.0	4,235.6	4,245.6	(395.4)	(9.3)	9.9	0.2
2004	4,605.5	4,450.5	4,518.7	(86.8)	(1.9)	68.2	1.5
2005	4,490.5	4,793.8	4,841.3	350.8	7.8	47.5	1.0

* The adjusted original estimate is the estimate made in November or December prior to the start of the next fiscal year in July and adjusted to account for legislation enacted, if any, which affected receipts to the SGF.

** The final estimate made in March, April or June is the adjusted original estimate plus or minus changes subsequently made by the Consensus Estimating Group. It also includes the estimated impact of legislation on receipts.

The table (above) presents estimates compared to actual receipts since FY 1975, the fiscal year for which the current process was initiated. First, the adjusted original estimate is compared to actual collections and then the final estimate is compared to actual receipts.

As might be expected, there has usually been a smaller difference between actual receipts and the final estimate because only three months remained in the fiscal year when the final estimate was made. In the last 15 fiscal years, the most significant shortfall in receipts relative to the final estimate was FY 2002 (4.9 percent); while the largest percentage underestimate occurred in FY 1994 (1.6 percent).

Concluding Comments

Consensus revenue estimates are based on current federal and state laws and their current interpretation. The Consensus Group will meet again in April to revise these estimates. Developments which occur between the November and April meeting will be taken into account at that time.

Table 1
State General Fund Receipts
(Dollars In Thousands)

	Consensus Estimates, November 3, 2005					
	FY 2005 (Actual)		FY 2006 (Revised)		FY 2007	
	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change
Property Tax:						
Motor Carrier	\$20,454	4.9 %	\$22,000	7.6 %	\$23,000	4.5 %
Motor Vehicle	1,801	(96.1)	25	--	--	--
Ad Valorem	538	16.9	775	--	--	--
Total	\$22,793	(34.4) %	\$22,800	0.0 %	\$23,000	0.9 %
Income Taxes:						
Individual	\$2,050,562	8.6 %	\$2,230,000	8.8 %	\$2,360,000	5.8 %
Corporation	226,072	60.1	260,000	15.0	260,000	--
Financial Inst.	22,063	(13.3)	23,000	4.2	24,000	4.3
Total	\$2,298,697	11.9 %	\$2,513,000	9.3 %	\$2,644,000	5.2 %
Estate Tax	\$51,853	7.9 %	\$51,000	(1.6) %	\$52,000	2.0 %
Excise Taxes:						
Retail Sales	\$1,647,663	2.2 %	\$1,715,000	4.1 %	\$1,729,000	0.8 %
Compensating Use	244,755	14.1	265,000	8.3	268,000	1.1
Cigarette	118,979	(0.7)	118,000	(0.8)	117,000	(0.8)
Tobacco Products	5,039	5.0	5,000	(0.8)	5,000	--
Cereal Malt Bev.	2,077	(4.1)	2,000	(3.7)	2,000	--
Liquor Gallonage	15,736	(0.7)	16,000	1.7	16,000	--
Liquor Enforcement	41,904	4.1	44,000	5.0	45,500	3.4
Liquor Drink	7,444	4.1	7,700	3.4	7,900	2.6
Corp. Franchise	47,095	28.0	45,000	(4.4)	46,000	2.2
Severance	103,390	22.2	131,100	26.8	111,800	(14.7)
Gas	75,415	14.2	93,400	23.8	77,600	(16.9)
Oil	27,975	50.5	37,700	34.8	34,200	(9.3)
Total	\$2,234,082	4.5 %	\$2,348,800	5.1 %	\$2,348,200	-- %
Other Taxes:						
Insurance Prem.	\$106,828	-- %	\$110,000	3.0 %	\$112,000	1.8 %
Miscellaneous	4,291	(2.2)	4,300	0.2	4,300	--
Total	\$111,119	(0.1) %	\$114,300	2.9	\$116,300	1.7 %
Total Taxes	\$4,718,544	7.6 %	\$5,049,900	7.0 %	\$5,183,500	2.6 %
Other Revenues:						
Interest	\$23,257	67.7 %	\$62,800	170.0 %	\$87,300	39.0 %
Net Transfers	23,562	40.9	(14,800)	--	(115,000)	--
Agency Earnings	75,908	(24.8)	60,000	(21.0)	62,500	4.2
Total	\$122,727	(6.7) %	\$108,000	(12.0) %	\$34,800	42.0 %
Total Receipts	<u>\$4,841,271</u>	<u>7.1 %</u>	<u>\$5,157,900</u>	<u>6.5 %</u>	<u>\$5,218,300</u>	<u>1.2 %</u>

Table 2

State General Fund Receipts – Comparison of Estimates for FY 2006
Made on June 14, 2005, as adjusted, with those made on November 3, 2005
(Dollars in Thousands)

	Estimate* 6/14/05	Revised Estimate 11/3/05	Difference	
			Amount	Percent Change
Property Tax:				
Motor Carrier	\$24,000	\$22,000	\$(2,000)	(8.3) %
Motor Vehicle	--	25	25	--
Ad Valorem	--	775	775	--
Total	<u>\$24,000</u>	<u>\$22,800</u>	<u>\$(1,200)</u>	<u>(5.0) %</u>
Income Taxes:				
Individual	\$2,130,000	\$2,230,000	\$100,000	4.7 %
Corporation	210,000	260,000	50,000	23.8
Financial Inst.	22,000	23,000	1,000	4.5
Total	<u>\$2,362,000</u>	<u>\$2,513,000</u>	<u>\$151,000</u>	<u>6.4 %</u>
Estate Tax	\$52,000	\$51,000	\$(1,000)	(1.9) %
Excise Taxes:				
Retail Sales	\$1,700,000	\$1,715,000	\$15,000	0.9 %
Compensating Use	250,000	265,000	15,000	6.0
Cigarette	116,500	118,000	1,500	1.3
Tobacco Products	5,000	5,000	--	--
Cereal Malt Beverage	2,000	2,000	--	--
Liquor Gallonage	15,500	16,000	500	3.2
Liquor Enforcement	44,000	44,000	--	--
Liquor Drink	7,700	7,700	--	--
Corp. Franchise	46,000	45,000	(1,000)	(2.2)
Severance	102,200	131,100	28,900	28.3
Gas	72,700	93,400	20,700	28.5
Oil	29,500	37,700	8,200	27.8
Total	<u>\$2,288,900</u>	<u>\$2,348,800</u>	<u>\$59,900</u>	<u>2.6 %</u>
Other Taxes:				
Insurance Premium	\$104,000	\$110,000	\$6,000	5.8 %
Miscellaneous	4,300	4,300	--	--
Total	<u>\$108,300</u>	<u>\$114,300</u>	<u>\$6,000</u>	<u>5.5 %</u>
Total Taxes	\$4,835,200	\$5,049,900	\$214,700	4.4 %
Other Revenues:				
Interest	\$54,000	\$62,800	\$8,800	16.3 %
Net Transfers	(18,432)	(14,800)	3,632	--
Agency Earnings	66,152	60,000	(6,152)	(9.3)
Total Other Revenue	<u>\$101,720</u>	<u>\$108,000</u>	<u>\$6,280</u>	<u>6.2 %</u>
Total Receipts	<u><u>\$4,936,920</u></u>	<u><u>\$5,157,900</u></u>	<u><u>\$220,980</u></u>	<u><u>4.5 %</u></u>

* As adjusted for legislation enacted during the 2005 Special Session.